OHT Guide

Corporation Tax Losses & Group Company Surrender of Losses

During the Celtic Tiger years many companies were making annual profits and paying corporation tax. However, following the downturn in the economy, significant losses have accrued to some companies. A company in financial difficulties may never get a chance to use the losses but a company that can trade through the downturn can stockpile losses and carry them forward for future use.

The nature of a loss will determine how it can be used in the future. S. 396 and S. 396A Taxes Consolidation Act 1997 provide for the set off of trading losses incurred by a company in an accounting period. Under these sections trading losses can be set off first against current year trading profits and then against prior period trading profits (restricted to preceding periods of the same length). If the preceding period is of a differing length (e.g. If the current period is 6 months but the last period was 12 months) the loss is apportioned to establish the loss arising for the equivalent period (as the loss can be set back against profits arising in the last 6 months of the prior 12 month period).

Trading losses can also be used to offset passive income profits in the current period on a value basis. Passive income is taxed at 25% and trading income is taxed at 12.5% so the trading loss needs to be twice the value of the passive income it is being used to shelter.

Example

Tradeco made a trading loss of €20,000, but received passive investment income of €15,000. As the value of the tax loss is €2,500 (12.5% of €20,000) this can only be used to shelter €10,000 of the investment income (sheltering €2,500 in tax at the 25% rate). The balance of the passive income (€5,000) will give rise to tax.

Trading losses made must be claimed within 2 years of the end of the period in which the loss is made. Restrictions may apply where the relevant return is filed late (S. 1085 TCA 97).

Case III (foreign) losses are ring-fenced to Case III foreign income arising from the same source, and cannot be set against Case I trading profits or Case V rental income profits. Case V rental losses are also “ring-fenced” to Case V rental profits.

Order of Loss Relief

The order in which company loss relief can be claimed, when trading losses are incurred by a company, is set out in the legislation and is summarised below:

- Losses which are carried forward from an earlier accounting period are claimed first.
- Losses incurred in the current year which can be set against current year profits are allowed next.
- Losses incurred in the current year that can be set against earlier periods should be used next.

Where the losses cannot be used in the current period or set back against profits of an accounting period of equal length then these losses can be carried forward to be set against future profits of the same trade.

Group Company Losses

S. 411 TCA 97 provides for a mechanism whereby losses of a member of a corporation tax group can be surrendered to another member of the group.

In order to be considered a corporation tax group (and be able to avail of the surrendering losses provisions for companies within the group) one company must be a subsidiary of another company or both companies must be subsidiaries of a third company.

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The companies must also be resident in the European Union or in an EEA country with which Ireland has a Double Taxation Agreement.

To qualify as a group for the purposes of surrendering losses one of the companies involved in the surrender must be a 75% subsidiary of the other company. This is a considerably higher ownership requirement than the ownership test set out in S. 410 TCA 97 which allows the making of payments between group companies without deducting withholding tax. The payments legislation only requires that one company is a 51% subsidiary of the other.

Where companies are members of a losses group they can surrender losses to each other. However it should be noted that the surrender of losses is only allowed between Irish resident companies, or branches that are within the charge to corporation tax in Ireland.

Losses that arise to a non resident company, that is not within the charge to Irish corporation tax, cannot generally be surrendered to an Irish group member, but an exception is made if the loss is a "trapped loss".

Where the surrendering company is not resident in Ireland but is resident in a EEA Member State or a country with which Ireland has a Double Taxation Agreement (a "DTA Partner") then S. 420C TCA 97, which deals with trapped losses, may apply.

A trapped loss is a loss which cannot be used by the company to which it arose, or any other company in the surrendering EU State, or DTA Partner, in:-

- the current accounting period,
- a previous accounting period, or
- a future accounting period.

A "trapped loss" can occur where the surrendering company is going into liquidation, or the loss cannot be used due to some other legal provision in the jurisdiction in which the loss arose.

A claim for the surrender of a trapped loss must be made within 2 years of the point in time where it is established that the surrendering company cannot use the loss in any later accounting period (S. 420C (5) TCA 97).

S. 420C TCA 97 was introduced following the ECJ case of Marks & Spencer plc v Revenue and Customs [2009] UKFTT 231. This case involved a German subsidiary of the UK based parent company Marks & Spencer plc. The German subsidiary company was ceasing to trade and could not use its losses so it wanted surrender them to its UK parent. UK legislation (on which the Irish legislation is closely modelled) did not allow non resident subsidiaries to surrender losses to UK parent companies.

The ECJ held that this provision was contrary to the provisions of Articles 43 & 48 of the EC Treaty in relation to the freedom of establishment. However it did state that to allow companies to surrender losses cross border could result in issues in terms of the imposition of taxes across the EU and could give rise to a risk that losses might be used more than once in different Member States.

The ECJ held that where the surrendering company has exhausted all possible means of utilising the loss (i.e. it simply cannot use them at any time) then the losses can be surrender to other group companies in different Member States.

Conclusion

Many companies are going through difficult trading periods at the moment and significant losses are being generated it is important that such losses are captured in full and claimed by the relevant company so that they are available for use in future years.

Many companies expanded their operations to other EEA Member States (and beyond) in recent times, and in some cases these expansions are now being reversed. There appears to be scope for Irish resident companies to capture the losses of EEA resident or DTA country resident group companies that are to cease trading or have already ceased trading. Such losses could shelter a significant level of profits of the Irish company going forward.

If tax advice is required on any point covered in this article , please email info@ohanlontax.ie.